The Impact of Liberalisation:

Communicating with APEC Communities

Furniture Industry in Canada

November 1998

Acknowledgments

In Vancouver in November 1997, APEC Leaders and Ministers requested that work be undertaken to promote community understanding of the impact of liberalisation. A broad project was conceived by a Steering Group established under the APEC Committee on Trade and Investment (CTI).

This series of papers, "The Impact of Liberalisation: Communicating with APEC Communities", was prepared as part of the broader initiative. The papers include a review of research on the effects of liberalisation, a series of case studies and a summary report.

The publication series was implemented jointly by a consortium of the APEC Study Centres Network and the Pacific Economic Cooperation Council (PECC) under a contract from the APEC Secretariat. Project managers were Alan Oxley, Director of the Australian APEC Study Centre, and Christopher Findlay, Chair of PECC's Coordinating Group and Associate Professor of Economics at the University of Adelaide, with the support of PECC Director General, PC Leung.

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The Summary was prepared by David Uren.

The reports were produced at the Australian APEC Study Centre at Monash University in Melbourne, Australia. Publications were coordinated and edited by Jo Bosben, Assistant Director, Australian APEC Study Centre. Design and print production was done by Lazy E Dude Ranch.

November 1998

APEC #98-CT-01.6

ISBN 1-876238-14-3

APEC Secretariat

438 Alexander Road 14-61/64, Alexander Point Singapore 119958

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Summary

Although now a $US 6.3 billion industry, furniture manufacturing in Canada still bears the marks of its origins as a cottage industry. Much of the industry is composed of family firms. Most family firms run single plant, small operations with the sales less than a third the size of the average Canadian manufacturing firm.

It was an industry ill-prepared for the Canada-US Free Trade Agreement signed in 1989. It had little experience in export markets and had depended upon tariff protection of between 12.5 percent and 15 percent to compete in the domestic market against larger, American competitors.

Companies typically produced a wide range of products, each with small production runs, to fill the diverse needs of the small Canadian market.

On the eve of the tariff cuts, the Quebec Furniture Manufacturers' Association said free trade was "a rather formidable challenge and threatens its very existence".

The challenge was in fact greater than the industry expected. The effect of reduced tariff protection was compounded by both a severe recession and an appreciation of the Canadian dollar.

For several years, the forecasts of doom appeared well founded. From 1989 to 1994, the number of furniture manufacturing establishments fell by a third and employment in the industry dropped 25 percent. There was some growth in exports, but it was nowhere near enough to compensate for the contraction in the domestic market and the erosion of the Canadian manufacturer's share of that market. While the domestic market contracted, the importers increased their share of the market from 21 to 32 percent.

In 1992, however, a recovery began. Although there are fewer firms and employees in the industry now than there were before it was exposed to international competition, output is 36 percent higher than it was. The industry has become much more internationally focussed, with exports soaring from less than $US 900 million to about $US 3.5 billion. The industry now exports 55 percent of its output.

The crisis caught firms in different stages of preparedness. Canadel Furniture is a family owned company that makes casual dining furniture, which is a small segment of the market. As early as 1985, it could see that a free trade agreement would eventually come to pass. Its managers started "dreaming" about what they could do in the United States market and travelling extensively there. The company's key selling point is a design system that gives customers many options over fabrics, components and models and it guarantees delivery in under six weeks.

It believes the free trade agreement and NAFTA were the best things that ever happened to the firm. Since 1992, exports have risen from 20 percent to 75 percent of their output, while turnover has risen from $Cnd 23 million to $Cnd 62 million.

The Canadian subsidiary of the US office furniture manufacturer, Steelcase Inc., was initially less confident. Both management and staff felt that Steelcase Canada was not ready for free trade. A number of US subsidiaries in Canada had responded to the agreement by closing their Canadian plant. Steelcase Inc's initial response was to attempt to run the Canadian operation from the US, eliminating some Canadian management posts.

It soon became evident that the company was going to lose its position in the Canadian market and a different strategy was devised. Prior to the free trade agreement, Steelcase Canada had produced 12 products, exporting a small portion to the US and selling the rest domestically. The Canadian operations were considered high cost and complex because of their high production runs. Trade within the group was strictly controlled, with subsidiaries only exporting as much as they imported, in order to remove foreign exchange exposure.

The new strategy demanded

that all Steelcase subsidiaries bid for the exclusive rights to produce specific Steelcase products and to market them worldwide. Plant managers had to establish that their production costs were lowest and that quality standards would be maintained. The number of products produced in Canada was cut to four, however the value of production more than doubled.

A general feature of the Canadian industry's response to free trade has been a shift towards more specialised, higher value added segments of the market. The household sector's share of the market declined from 43 percent in 1988 to 36 percent by 1997. The share of office and other sectors of the market rose from 57 to 64 percent.

There has also been a trend towards bigger firms and greater concentration of production. The average sales per factory rose from $US 2.3 million in 1988 to $US 4 million by 1996, however this is still significantly smaller than the average US factory.

Productivity increased dramatically, with the value-added per employee rising from $US 37,565 to $US 62,244 over the same period although it remains 20 percent below the more capital intensive US industry.

Companies have also developed more focussed distribution strategies. Durham Furniture was the subject of a management buy-out after it had gone into receivership in 1992. In addition to eliminating most of its product lines, the new management also adopted a new distribution philosophy of establishing closer relations with a smaller number of retailers. The approach was that no two retailers would compete in the same market.

A similar approach was taken by one of Canada's largest manufacturers, Palliser. It realised that its best retailers in Canada were being targeted by US manufacturers. It took the tough decision to eliminate almost half its 800 retailers, and accept, as an immediate consequence, the loss of 10-12 percent of their Canadian business.

One of the fears before the free trade agreement was that Canadian industry would de-camp to the United States. A few companies did so, however very few have made a success of it. Palliser already had a plant in the US that was closed because it was too small. A larger facility was opened in North Carolina, motivated by the conventional wisdom that wage rates were lower in the US. These cost savings have not been realised and the firm says the profitability of the plant is doubtful.

Palliser remains concerned that most of its investment remains in Canada. The passage of the NAFTA Agreement in 1994 superseded the US-Canada Free Trade Agreement. Canadian tariff barriers to Mexican imports are coming down in stages, heralding a new round of competition. Palliser expects to expand its operations in Mexico.

The primary response by Canadian producers to trade liberalisation was to shift to higher value products, leaving the lower cost end to the big United States companies. There is some concern that as Mexican produce starts making its presence felt in the United States, US producers may move up the value chain renewing the pressure on Canadian companies.

There is also a recognition that Canada needs to diversify its export markets. The US accounts for 96 percent of Canada's furniture exports (representing 20% of the US furniture imports). A recession in the industry, which is prone to strong cycles, would hit hard. Trade liberalisation in APEC is seen to present opportunity for new markets, although it also exposes Canada's producers to new sources of competition.

Background

Furniture manufacturing has been a part of Canada's industrial and cultural heritage for as long as the history of the country. Starting out as a cottage industry which served local markets, furniture manufacturing in Canada has today evolved into a $Cnd 6.3 billion dollar business that is heavily dependent on international trade, and which is based on advanced design, production, and distribution practices.

Some of the most profound changes in the industry have taken place in the last decade, starting with the 1989 Canada-United States Free Trade Agreement (FTA). During this turbulent period, the Canadian furniture industry faced not only economic integration with its much larger US counterpart, but also a sharp recession, a major change in the tax code, and large currency adjustments. This paper surveys the dramatic changes in the industry during this period, and examines the impact of the FTA in particular. In addition to an overall industry assessment, the report contains four case studies which illustrate the impact of trade liberalisation at the firm level.

The furniture industry plays a relatively small role in the Canadian economy. It is the country's sixteenth-largest manufacturing industry and contributes 0.25 percent to GDP. Furniture shipments account for 1.3 percent of total manufacturing shipments and the number of furniture establishments make up 4.3 percent of total manufacturing firms. In terms of its contribution to manufacturing employment, the furniture industry accounts for a modest 2.9 percent. The furniture industry is, however, a large consumer of intermediate inputs, especially textiles and wood products.

Table 1: Selected indicators on the Canadian Furniture and Fixtures Industry, 1997

No. of Establishments	*1406*
Employment	*49298*
Shipments ($Cndm)	6301
Exports ($Cndm)	3491
Domestic Shipments ($Cndm)	2810
Imports ($Cndm)	1747
Canadian Market ($Cndm)	4557
Exports as % of Shipments	55.4
Imports as % of Canadian Market	38.3
Total wages and salaries($Cndm)	*1380.5*
Value Added ($Cndm)	*3068.5*

Figures in italics are for the year 1996

Source: Industry Canada and Statistic Canada, catalogue 35-251 Annual, Furniture and Fixtures Industries.

The Canadian furniture industry may be divided into three broad segments: household, office, and "other". The "other" segment includes institutional furniture, bed springs and mattresses, and various furniture components. Household is the largest segment, accounting for 36 percent of total industry shipments and 48 percent of establishments. Office furniture constitutes about 28 percent of total shipments and 12 percent of industry establishments, with "other" making up the balance.

The vast majority of establishments are Canadian family-owned, a characteristic of the industry that has remained largely unchanged for generations, even in the aftermath of the FTA. Currently, only about 3 percent of plants are foreign-owned, mostly by American multinationals.

The average furniture manufacturing plant employs fewer people and has shipments that are lower than the average for the manufacturing sector as a whole. In 1996, the average furniture plant employed 35 people and generated shipments around $US 3.9 million, compared with 53 employees and $US 12.1 million in shipments for the average Canadian manufacturer.

One of the most distinctive features of the industry's evolution over the last decade has been its

Policy Review

growing export orientation. In 1997, furniture manufacturers exported 55 percent of their output, an increase of more than three-fold compared to 1989. The contribution of furniture exports to total Canadian merchandise exports over this period doubled to its current level of about 1.0 percent.

The rise in exports is especially important given that the domestic market has been essentially flat over the last ten years. From a peak of about $US 5 billion in 1989, the market shrank by about 20 percent over the next four years, and has since recovered to around $US 4.5 billion in 1997. About 30 percent of the domestic market is supplied by imports, chiefly from the United States.

The FTA was one of the most hotly debated issues in Canadian political discourse. It exposed a deep divide amongst Canadians specifically on the need for closer economic relations with the United States, but more generally on the "globalisation agenda". The furniture industry was at the centre of most debates on free trade's impact on the corporate sector. Even amongst supporters, the furniture sector was widely believed to end up as a loser, albeit a loss that would be more than made up by efficiency gains in the Canadian economy as a whole.

Writing in 1988, a senior representative of the Quebec Furniture Manufacturers' Association described free trade as "a rather formidable challenge and (one which) threatens its very existence".[1] The reasons for this widely-held belief were clear: the Canadian furniture industry was protected by tariffs of as much as 15 percent and consisted of mostly small and inefficient firms, compared to their US counterparts. The low productivity of Canadian manufacturers was due to a lack of scale economies, use of outdated technologies, and high production costs.

Table 2 shows the Canadian and US tariff structures for selected furniture products at the end of 1988, and the schedule of tariff elimination under FTA. Prior to January 1, 1989, the average Canadian tariff was in a range of 12.5 -15 percent, compared with 2.5-7 percent in the US. In addition, a number of non-tariff barriers were slated for elimination or harmonisation under FTA, including labelling, consumer protection, and pollution standards. Under the FTA, tariffs on the vast majority of furniture products were to be eliminated over five years, in equal annual increments. Many Canadian manufacturers had lobbied for a longer phase-out period, arguing that the industry would be decimated under such a short time frame.

Many furniture manufacturers

Table 2: U.S. - Canada Free Trade Agreement Schedule of Tariff Eliminationfor Selected products

Description	Base rate of tarif %		Elimination period in years
	Canada	U.S.	
Household furniture (wood, case goods)	15	2.5	5
Household furniture (metal)	12.6	4	5
Office furniture (metal, case goods)	12.7	4	5
Office furniture (wood)	15	6.6	5
Upholstered furniture	15	7	5
Kitchen furniture	15	2.5	5
Mattress supports	12.5	4	10
Mattress	15	6	10
Prefabricated furniture parts (wood	15	2.5	5

Note:
1. The tariff rate in the chart represents typical tariff rate for certain categories. Different products usually have different tariff rate.
2. The schedule of tariff elimination begins at January 1, 1989.

Source: The Canada-U.S. Free Trade Agreement: tariff schedule of Canada and tariff schedule of the United States, Canada Department of External Affairs, 1987.

1 Claude Jutras, "The Impact of Free Trade on the Furniture Industry in Canada", *The Entrepreneurship Development Review*, Issue No. 5, 1988.

Table 3: Policy and Strategic Responses to the Canada-United States Free Trade Agreement

Government Policy Measures

- Assist export market development through trade shows, incoming buyers missions, market studies, and education seminars;
- Assist industry stakeholders in making sound strategic business decisions by providing statistics and other information;
- Create an Industrial Adjustment Service Committee to analyze and review human resources and training system. Develop innovative training curriculum and help address social factor and human resource issues arising from adjustments;
- Create Furniture Sector Campaign and offer financial supports to help upgrade design, quality and productivity;
- Set up national product standards and ensure harmonization of the Canadian and the U.S. standards. Help firms understand the Buy America Act and European product and performance standards.
- Offer provincial awards to recognize design and marketing achievements, and provincial tax credit for design costs.

Strategic Adjustments by Manufacturers

- Explore export opportunities in the U.S. market aggressively, move and open showrooms in the southern U.S.;
- Concentrate on specific product lines, remove non-competitive product lines, lower cost through production and distribution consolidation;
- Focus on niche markets, pay attention to specific customer needs, increase responsiveness to customer needs, enhance timely delivery and flexibility;
- Offer superior product design, quality product, improve customer service, build strong brand name recognition and cutomer loyalty;
- Invest in the state-of-the-art technologies and equipment, enhance capabilities for innovative design and unique style product, and improve productivity;
- Increase value/weight ratio and reduce transportation cost.

Source: Industry Canada 1996, 1997a; Art DeFehr 1989; Ryan B. 1992; Bagley, D. 1990.

were also penalised by a longer (10 year) tariff reduction schedule for various furniture materials and supplies (in particular textiles), compared to the 5-year schedule imposed on the finished products. The longer phase-out was a significant burden on the industry, given that intermediate inputs accounted for as much as 50 percent of the value of shipments. Partly as a result of lobbying by the industry, the tariffs on furniture materials and supplies were eventually eliminated over seven years, under a provision for accelerated tariff reductions in the FTA.

The elimination of tariffs on furniture products was mitigated somewhat by a policy shift on taxation. In 1991, the government introduced a 7 percent goods and services tax while eliminating a manufacturers' sales tax of 13.5 percent. For domestic sales, the net effect of the tax changes was a saving of as much as 6.5 percent at the retail level. Exported items, on the other hand, benefited to the full amount of the previous manufacturers' sales tax since GST is not applied on sales outside of the country.

To assist the industry adjustment to free trade with the US, the Canadian federal and provincial governments launched a number of initiatives designed to boost the competitiveness of Canadian manufacturers and to enhance their ability to sell in the US market. These initiatives are summarised in Table 3. By far, the more important adjustments were those taken at the company level by firms which had the foresight and resources to prepare for the more competitive environment brought about by free trade with the US. Some of these strategic adjustments are also summarised in Table 3.

Impact of Trade Liberalisation

The debate on the impact of the FTA on the Canadian economy has persisted ten years after the agreement was signed. Most mainstream economists believe that while the impact of FTA is difficult to disentangle from other factors in the Canadian and global economies during the first half of the nineties, the net effect on output and trade was resoundingly positive whereas the effect on employment was neutral or ambiguous.[2]

The Canadian furniture industry may be considered a microcosm of the impact of free trade on the economy as a whole, especially in relation to output, trade, and employment. As with an analysis of the impact of FTA on the overall economy, it is difficult to disentangle the effect of other factors on the industry. However, it would not be unreasonable to weigh any assessment of the FTA's impact on the furniture industry against the widespread expectation (pre-agreement) that the industry would be one of its worst casualties. In stark contrast to the grim assessments pre-FTA, the recent outlook for the industry is as rosy as for any manufacturing sector. For example, the Canadian Imperial Bank of Commerce has singled out furniture manufacturing as the manufacturing growth leader for the rest of the decade, with an average annual growth rate of nearly 12 percent.

In the years immediately following the implementation of FTA, it appeared as if the dire predictions for the industry would become reality. From 1989 to 1994, the number of establishments fell from 1845 to 1238. Over the same period, employment declined from around 63,000 to 47,000. Industry shipments also declined from about $US 4.9 billion in 1989 to a low of $US 3.8 billion in 1992. This was a period which coincided with a recession in Canada, marked in particular by a sharp fall in residential construction and business investment.

The strong Canadian dollar during this period was another factor that added to the industry's difficulties. Between 1988 and 1991, the Canadian dollar appreciated by over seven percent against the US dollar. It has fallen steadily since that time, and in 1997 reached record lows.

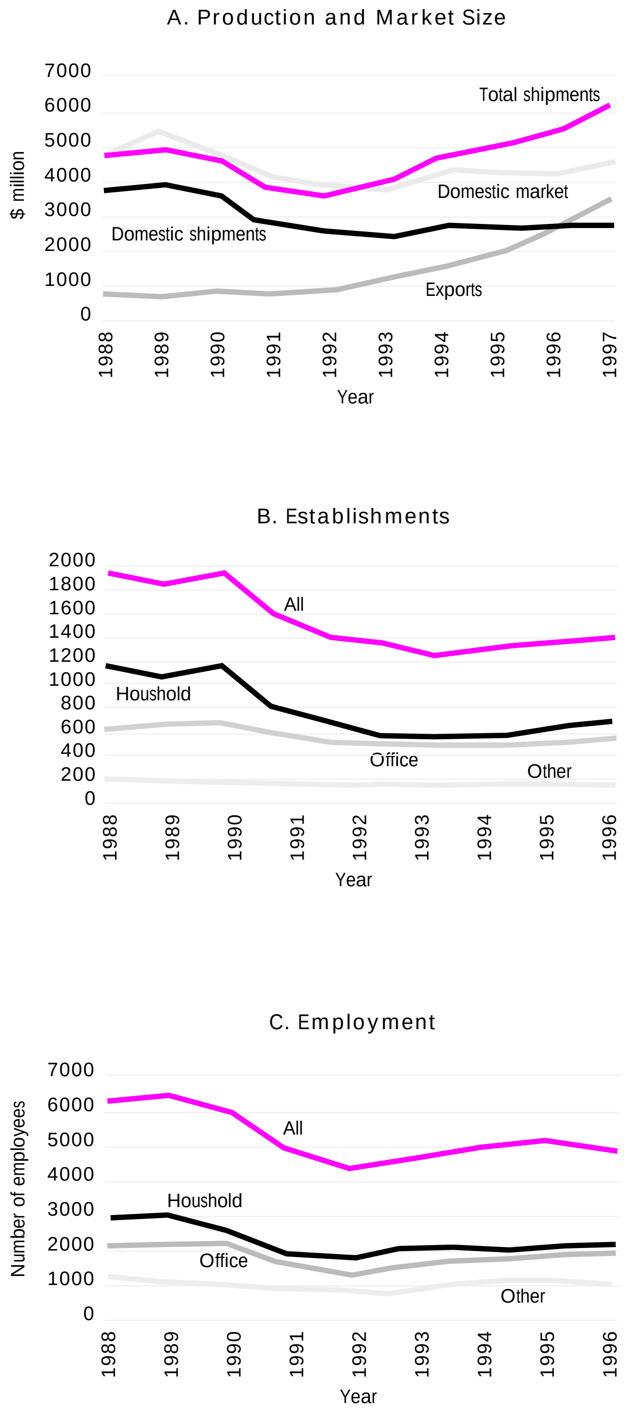
Along with the contraction in output and employment in the early 1990s came ownership restructuring, as well as mergers and acquisitions. A number of firms also considered relocating to the Southern United States (especially Mississippi and South Carolina) as a way of lowering production costs and generating larger scale economies.

The sharp downturn in the industry led many firms to under-

In stark contrast to the grim assessments pre-FTA, the recent outlook for the furniture industry is as rosy as for any manufacturing sector.

2 Daniel Schwanen, *Trading Up: The Impact of Increased Continental Integration on Trade, Investment and Jobs in Canada*, C.D. Howe Institute, Ottawa, 1997.

Chart 1: Changes in the Industry, 1988 – 1997



take strategic adjustments. It was widely recognised within the industry that Canadian manufacturers were disadvantaged by high production and transportation costs, outdated technologies and equipment, and inferior design and innovation capability, compared to large US firms. Many Canadian firms were preparing for strategic adjustments and rationalisation even before FTA, convinced that a more open and competitive trading environment was inevitable.

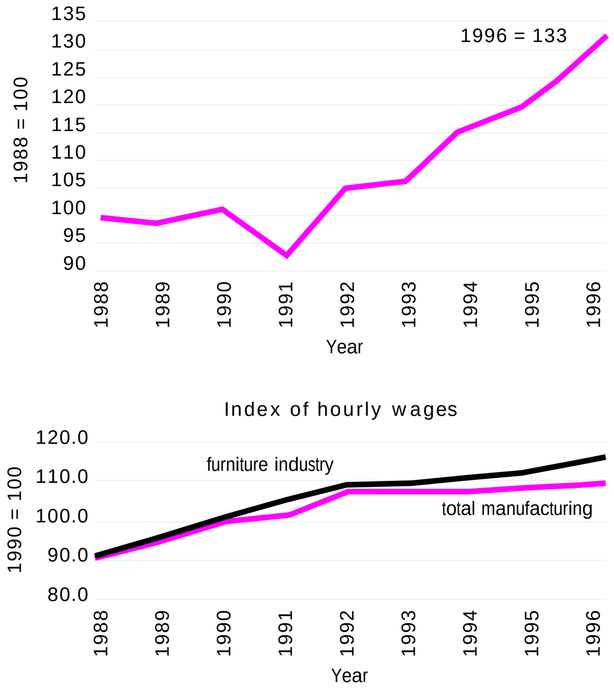
Broadly speaking, the adjustment strategy pursued by most firms was to specialise in specific product lines with timely delivery and a focus on quality and service, rather than to relocate production. Virtually all companies aggressively pursued US markets by carefully identifying product niches and cultivating relationships with retailers.

The turnaround in the industry started around 1992, about a year before the economy as a whole was pulling out of recession. By 1995, total shipments surpassed the 1989 peak and have since exceeded that level by about 36 percent. Export growth has been even more spectacular, with a increase of over 300 percent between 1989 and 1997 (see chart 1a). Canadian firms which responded to free trade by instituting strategic reforms emerged more competitive, and by the mid 1990s were positioned to take advantage of a buoyant American economy and weaker Canadian dollar.

The rebound in terms of number of establishments and employment has been more modest. The number of establishments in 1996 stood at 1,406, up from the trough of 1,238, but still well below the 1988 peak of 1,947 (see chart 1b). Employment also has not returned to pre-FTA levels, but in 1996 was about 14 percent higher than at the depth of the recession in 1992 (see chart 1c).

The industry's recovery between 1992 and 1997 has been led by the office and "other" furniture segments. While the household segment is still the biggest, its share of total industry shipment declined from 43 percent in 1988 to 36 percent in 1997. During the same period, office furniture rose from 24

Chart 2: Productivity of Furniture Industry
Inflation-adjusted value-added per employee



percent to 28 percent, and “other” furniture grew from 33 percent to 36 percent respectively. This shift reflects the move by Canadian manufacturers towards generally higher value-added office and “other” furniture segments. It also corresponds to growing imports from the US, especially in the area of lower-cost household furniture.

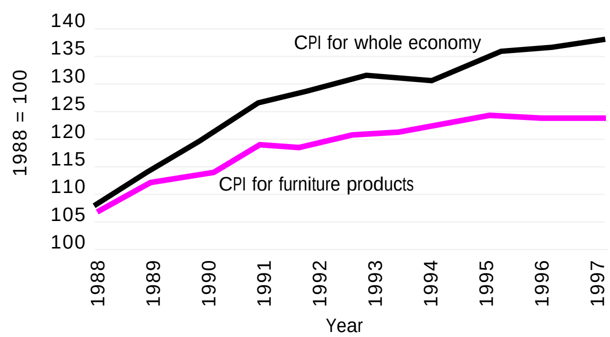
Another structural change in the industry has been the trend towards larger plants and greater concentration of production. The average shipment per factory rose from $US 2.3 million in 1988 to about $US 4 million in 1996. In the household segment, the top 10 plants in 1988 accounted for 17 percent of industry shipments and the top 100 for 62 percent. By 1994, the top 10 establishments accounted for 22 percent of shipments, and the top 100 produced 74 percent. The move to larger plants has allowed manufacturers to generate economies of scale. The average Canadian plant, however, continues to be substantially smaller than in the US, which reflects a business strategy based less on scale economies than on niche markets.

One of the most significant improvements in the industry during the last decade has been in productivity. Value-added per employee rose from $US 37,565 in 1988 to $US 62,244 in 1996. Even after adjusting for inflation, value-added per employee rose by 33 percent over this period, as shown in Chart 2. This increase in productivity was a direct result of the strategic adjustments undertaken by the industry in response to FTA. More specifically, the industry invested in new technologies, equipment and machinery, and in workforce training.

Furniture industry employees have not benefited as much from the turnaround in the sector. The inflation adjusted annual salary per employee increased by 4 percent from 1988 to 1996, and average hourly wages rose very modestly from $US 9.9 in 1989 to $US 11.80 in 1996. After adjusting for inflation, hourly wages in the industry were essentially flat over this period (see chart 2).

Consumers have also benefited from trade liberalisation in the furniture industry. The removal of import tariffs as well as the improved efficiency in domestic industry has resulted in cost savings and greater choice for consumers. Chart 3 shows that the price index for furniture products has risen by considerably less than the consumer price index as a whole.

Chart 3: Consumer Price Indexes
Furniture products vs whole economy



Implications for Trade Opportunities

The integration of furniture markets in Canada and the US brought about by FTA has tended towards greater specialisation on the part of Canadian firms.

The explosive growth in two-way trade in furniture products since 1989 has been one of the most compelling arguments for the success of the FTA. The increase in Canadian exports was especially pronounced, as pointed out in the previous section, and has resulted in a overall trade surplus for Canada since 1993. By 1997, the surplus was $US 1.7 billion, compared with 1988 when imports and exports were roughly in balance. The bilateral Canada-US trade balance in furniture products also grew from a small surplus of $US 336 million in 1988 (in Canada's favour) to $US 2.1 billion in 1997 (see chart 4).

The trade surplus has been especially large in the office and "other" furniture segments. In 1997, office furniture showed a surplus of $US 772 million, and "other" furniture accounted for $US 743 million, compared to a $US 229 million surplus in the household segment. Typical Canadian furniture exports include wooden bedroom furniture, metal filing cabinets, other office furniture, swivel seats, and upholstered seats. Canadian furniture exporters have developed a reputation for high quality, innovative design, responsiveness to customer needs, and good service (see chart 5).

Furniture imports between 1988 and 1997 more than doubled, with most of the growth accounted for by imports from the US. Broadly speaking, the integration of furniture markets in Canada and the US brought about by FTA has tended towards greater specialisation on the part of Canadian firms in higher value office and "other" furniture products, with US producers cap-

Chart 4: Export Orientation and Import Penetration

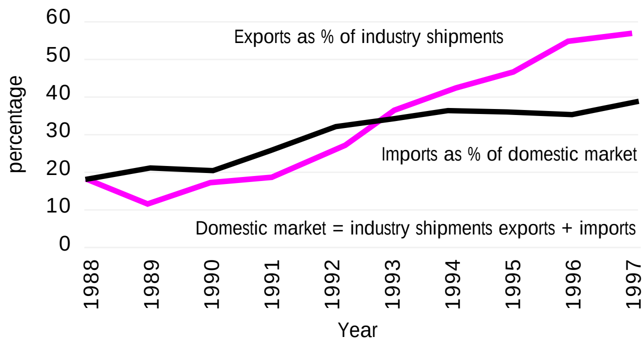
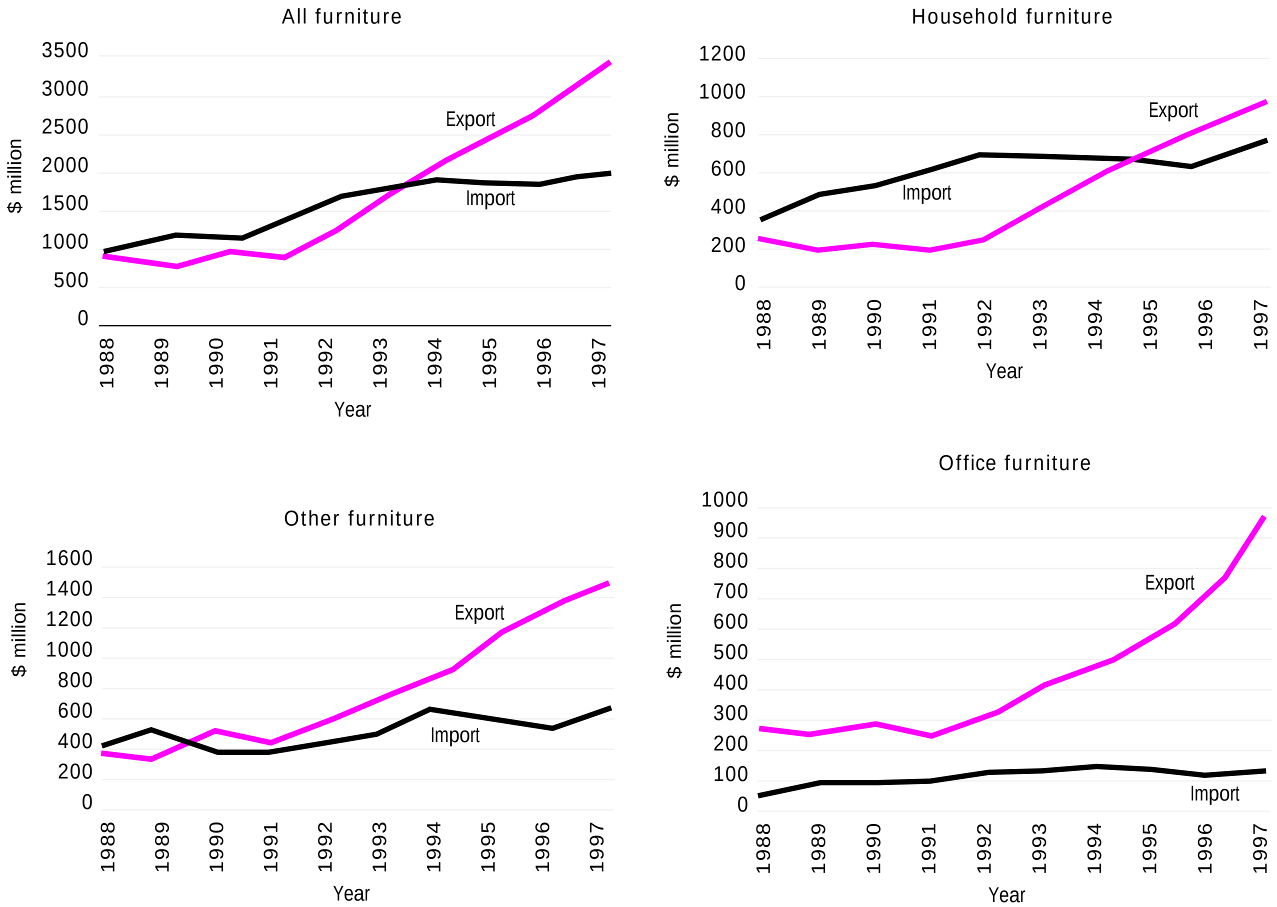


Chart 5: Exports and Imports of Furniture Industry



turing more of the lower-end household furniture market.

For historical and geographical reasons, Canada and the US have always been close trading partners. Even before FTA, Canadian furniture exports to the US accounted for 93 percent of total exports. FTA strengthened the trading relationship and by 1997, exports to the US accounted for 96 percent of total exports. Canada's share of the US imports grew from 8 percent in 1988 to about 20 percent currently. The Canadian share of the total US market, however, is less than 2 percent, which suggests that there is substantial room for export growth. At the same time, imports from the US which accounted for 56 percent of Canadian imports in 1988, currently stand at around 69 percent.

The next most important sources of Canadian imports are China (7 %), Italy (5 %), and Chinese Taipei (4 %). Asian imports as a whole have overtaken European imports with the European share falling from about 25 percent in 1988 to only 8 percent in 1997. Most furniture imports from Asia are low-priced items compared to high-end products from Europe, chiefly Italy.

Foreign Investment Developments

Despite fears that FTA would lead to a massive relocation of production from Canada to the United States or that the Canadian industry would be largely taken over by their larger and financially-stronger US counterparts, this fear has not materialised. While there has been a trend towards larger firms and greater concentration of production, the Canadian industry is still overwhelmingly Canadian owned, with a substantial portion held under family ownership.

In the immediate aftermath of FTA, several large Canadian furniture manufacturers considered opportunities in the US. Some opened showrooms in North Carolina and Mississippi and a few even closed their operations in Canada and moved South. The total amount of outward foreign investment was, however, trivial compared to the broader contraction in the industry through the recession of the early 1990s. As it turned out, there were very few success stories of Canadian firms relocating to the US and some Canadian manufacturers have recently closed their US plants to concentrate on Canadian operations. The fall in the Canadian dollar after 1992 contributed to the attractiveness of Canada as a production base but, as importantly, many Canadian firms pursued a strategy of high value, quality production rather than attempt to emulate the American strategy of generating economies of scale through high volume production.

Several large Canadian furniture manufacturers such as Dorel Industries Inc. and Palliser Furniture Ltd. have become international producers. Dorel, the largest furniture producer in Canada, generated 83 percent of its revenue from foreign based production in 1994, with plants in Europe, Asia and the US. These firms are exceptions in the industry, since most producers operate single plants based in Canada.

The FTA also did not result in an increase in foreign investment in Canada. Given the loss of tariff protection, this outcome is not surprising. What is surprising is the fact that a number of American-owned plants did not consolidate their operations in the US after FTA, when they no longer faced the disincentive of a high Canadian tariff. The example of Steelcase, a US-owned company, is described in this paper and illustrates how it transformed its strategy in Canada from one of producing a wide range of products for the domestic market to one of a global production mandate. Operations of US and other foreign-owned furniture plants in Canada have remained at a low but roughly constant level. Foreign-owned manufacturers are most important in the office furniture segment, where they account for about 5 percent of establishments and 20 percent of shipments.

While there has been a trend towards larger firms and greater concentration of production, the Canadian industry is still overwhelmingly Canadian owned.

Response of Local Firms

There is considerable variance in the four furniture manufacturers profiled in this section. The firms range from a large Canadian-owned firm that is considering the expansion of foreign production locations to a subsidiary of a US-based multinational trying to strengthen its position within the group. The common experience shared by each of the firms is that trade liberalisation precipitated profound changes in management and operational strategies, and in that way acted as a crucible for the firms to test their new approaches to doing business.

There were several characteristics common to the four companies prior to FTA. Foremost amongst them was a business strategy that focused almost exclusively on the domestic market. This strategy biased production towards small runs and the maintenance of a large number of product lines to satisfy the diverse, but low volume demand in Canada.

When the FTA came into effect, the firms profiled in this study immediately felt the pressure of import competition and, coincidentally, of a rapidly weakening domestic market. In general, the actions taken by these successful firms were to make significant cuts in selling prices, and to reduce both the variety of raw materials used, and the number of markets served. They also rationalised their use of distribution channels, focusing on new market niches, and placed renewed emphasis on product quality. In each case, total employment increased as these new strategies were implemented. The net effect of this tighter business focus was greatly expanded sales, increased net income, and improved confidence on the part of managers to take on global competition.

Trade liberalisation precipitated profound changes in management and operational strategies.

Canadel Furniture Inc.

Established in 1982, Canadel Furniture Inc. is a family-owed Canadian business located in the province of Quebec. The firm, with three assembly plants and one panel gluing plant, specialises in the design, assembly, finishing, and marketing of home furniture. Rather than attempting to supply a wide range of products to a small market, Canadel's strategy has been to focus on sales of casual dining furniture, a small segment of the home furniture market. This strategy was made feasible by unrestricted access to the US market that came with FTA.

Their success in achieving new markets is based on high product quality, design and production flexibility, and delivery reliability. This three-faceted strategy has enabled Canadel to realise prices that are, on average, 3-7 percent higher than rival products. Canadel has sought to remain market-driven despite the initial resistance of their US distributors who indicated a clear preference for standardised products. Through their unique "work-shop" design system, customers design their own casual dining furniture at the distributor's location by combining models, components, wood types, and fabrics. Canadel guarantees delivery to anywhere in the world in less than six weeks from the time of ordering.

Since the firm's inception in 1982, Canadel's annual sales have grown steadily, from $Cnd 16 million in 1987, to $Cnd 23 million in 1994, and $Cnd 62 million by 1997. Today, Canadel employs 675 people directly in their gluing and assembly plants, with an additional 750 people in firms that have subcontracted the supply of Canadel's wood components, up from about 140 in the early 1990s. The firm has become a leader in the North American market for dinettes and casual dining suites, producing over 2,000 tables and 8,000 chairs per week.

The initial impact of trade liberalisation was to cause Canadel to redouble their market research efforts in the United States. Even before, as it became clear that the FTA would become law in the near future, Canadel's management began to travel extensively throughout the US, "dreaming about better access to the US market." This was at a time when they had virtually no export sales. Not only were they trying to establish relationships with distributors and retailers, they were also searching for US manufacturers who were not competing in the casual dining furniture market segment and who were willing to allow Canadel to sell their products as an agent in Canada. As they became more familiar with doing business in the US, and once the FTA guaranteed access to this huge market, they began to realise the opportunities it presented for growth in Canadel's own line of home furniture. Today, about 75 percent of Canadel's total sales come from exports, up from about 20 percent in 1992. Significantly, while total sales have increased exponentially, the firm's domestic sales volume has changed little over the company's history.

With the FTA agreement in place, Canadel has never looked back. They believe that "the FTA and NAFTA are the best things that ever happened" to the firm. Today, Canadel believes they are on equal footing with any US furniture manufacturer although there are still "indirect protective barriers, primarily in the form of red tape." In addition, Canadel's management believes that, over time, trade liberalisation of the furniture industry will also bring about the uniform adoption of improved practices in other areas such as pollution standards, consumer protection, and labelling.

While trade liberalisation has had a dramatic impact on Canadel's exports, the impact on imports has been slight. Even before the introduction of the FTA and NAFTA, all wood fabrication for Canadel's products is carried out in Quebec. Further, Canadel purchases all raw materials and components from Canadian sources, with the exception of metal chair swivels that are procured in the US for the simple reason that they are not produced in Canada.

Canadel has been approached at least five times by US investors interested in purchasing its operations, but the company has consistently resisted divestment. In addition, several New England states have sent packages of information with invitations to discuss the benefits (including tax holidays) of transferring the Quebec-based business to the US. However, Canadel's management feels a certain loyalty towards Quebec and Canada and, more specifically to their workers and families.

Steelcase Canada Ltd.

Steelcase Inc., the Grand Rapids, Michigan based parent firm of Steelcase Canada Ltd., is the world's largest manufacturer of office furniture. Its main products are office furniture systems (for example, moveable panels, work surfaces, and lighting) seating products, group and individual storage products (for example, filing units and cabinets), desks, and casegood products (for example, bookcases and credenzas). In addition to the manufacture and shipment of office furniture, the organisation is involved in workspace planning and installation, furniture asset management and leasing, and refurbishing.

Throughout its 85-year history, Steelcase Inc. had been a privately held firm; in February 1998, however, the parent organisation listed its stock on the New York Stock Exchange although control of the firm remains with the original owners. Today, Steelcase Inc. generates total sales of almost $US 2.8 billion from its 31 manufacturing facilities in the US, Canada, and Mexico, and from 20 facilities connected to Steelcase through joint venture arrangements or licensing agreements.

Since FTA, both sales and exports have increased substantially at Steelcase Inc.'s Canadian subsidiary in Markham, Ontario. Steelcase Canada's total sales in 1987 were around $US 40 million, increasing to about $US 60 million by 1992, and $US 112 million in 1997. Today, Steelcase Canada supplies around 18 percent of the total Canadian office furniture market through its dealers in over 40 locations. The products sold by Steelcase Canada in its domestic market are supplied by its own production facilities as well as by other Steelcase facilities worldwide.

Although the financial performance of Steelcase's Markham plant had always been strong, the initial impact on the firm of trade liberalisation was to "scare everyone to death." At the time, the reaction toward the FTA in the ranks of Steelcase Canada's management and labour was "very negative." In retrospect, this response by the firm's employees was due to the fact that they were "insulated in their thinking" and there was "no plan to deal with the FTA, a force that was impossible to ignore."

The parent organisation's initial reaction to the FTA was to attempt to run the Canadian operation from the US. It became clear after a period of time, however, that the net effect of this "experiment" would be to reduce their Canadian market position to shambles since "no training or other preparations had been made."

Steelcase Inc.'s second approach to the rationalisation of their North American operations was to fundamentally change the way that manufacturing responsibilities were distributed within the organisation. Prior to the FTA, Steelcase Canada produced 12 products, exporting a small portion to the US and selling the majority domestically. At that time, the Canadian operations were considered "high cost and complex due to small production runs." In addition, there was a clear "lack of sophisticated production techniques" making it difficult for the operation to compete in the international market.

Although the parent firm could have simply sold the Markham, Ontario site at a handsome profit to housing developers given the dramatic rise in land values, Steelcase instead restated their commitment to the Canadian operations by infusing new capital into the plant, turning it into a world class facility. This coincided with a change at the parent company level in their overall approach to international production. Rather than allowing plants to manufacture products for local markets, all Steelcase operations were obliged to bid for the exclusive rights to produce specific Steelcase products and to market them worldwide. Plant managers had to prove to senior management that their production costs were not only the lowest in the Steelcase group, but also that the quality of Steelcase's products would be maintained and enhanced.

This initiative created a much greater internal focus on financial and production management skills and techniques to ensure that costs of production were competitive on an international basis.

While the US market still accounts for the majority of Steelcase Canada's shipments, non-US exports have grown to almost 10 percent of total sales. Prior to the FTA, Steelcase Canada rarely attempted to seek markets outside of the US. Today, Steelcase Canada actively markets their products worldwide with a particular emphasis on South America (Brazil in particular) and Europe.

Durham Furniture Ltd.

Durham Furniture Ltd. was originally established in 1898 in Durham, Ontario where the firm had always been the small town's main employer. In 1954, the company was sold to Kroehler Manufacturing Co, a large US firm based in Naperville, Illinois who also had a number of other Canadian furniture manufacturing facilities in locations such as Stratford, Edmonton, and Montreal. In 1979, Kroehler's Canadian holdings were sold, forming the furniture manufacturing component of Toronto-based Strathearn House Group. However, in February 1992, Strathearn went into receivership, the Durham facility was closed, its employees were laid off and over $Cnd 4 million in annual wages was lost to the community. In August of the same year, a group of the plant's managers, with the financial support of a number of local investors and an Ontario investment company, purchased the plant and equipment from the receiver, re-establishing Durham Furniture Ltd. as an independent furniture producer.

While reopening the company in the midst of a shakeout in the Canadian furniture industry was seen by many as a risky venture, the new owners were encouraged by the motivated workforce and well-maintained plant and equipment. Management felt that "if a market could be established, there was a good possibility that the company would be successful." The existence of free trade between Canada and the US was a "central part of their plan to restart Durham Furniture Ltd."

As part of Strathearn's Kroehler Furniture division, the Durham plant manufactured a wide selection of bedroom, dining room, and living room furniture at mid-range prices in both solid wood and various veneers. When it was re-established as a stand-alone entity, Durham Furniture eliminated the majority of its product lines and began producing only solid wood products. Today, Durham offers only eight styles of bedroom furniture in the upper price range.

At the time of its demise in 1992, the Durham operation was shipping about $Cnd 12 million of furniture annually within the Canadian market and employing 188 people. None of their product was exported, however, due to a 1979 agreement between Strathearn and Kroehler that prohibited shipments to the US.

At the firm's rebirth in 1992, Durham Furniture Ltd. had no sales, exports, or employees. However, 150 workers were hired back in the first year and, by 1997, total employment reached 350 almost double the number when it was part of Kroehler. Sales also expanded from zero in 1992 to over $Cnd 35 million by 1997 with exports accounting for approximately 75 percent of total shipments.

The initial impact of trade liberalisation on the firm is "difficult to separate from other factors that were taking a toll" on the Durham operation. At the time, the $Cnd dollar was strong, interest rates were high, and Canada was in the midst of an economic recession making for tough times in the furniture industry. The initial reaction on the part of most Canadian furniture retailers was to "aggressively seek out potential US suppliers to replace the weak domestic producers," thus compounding both the severity and the urgency of the problems faced by manufacturers.

Durham reacted by changing their basic approach to doing business. First, they decided that they "must have a much greater market orientation" rather than rely on the more traditional emphasis on production. For this reason, their senior marketing and furniture design personnel both live in the US, their primary market. In addition, Durham opened a permanent showroom in the US to maintain the exposure of their products. Second, given that there were a number of major US producers capable of producing large quantities of inexpensive furniture, management realised that "in order to survive it is essential to be a niche player." Third, since trade liberalisation had created far more competition between producers for the best retailers, Durham changed their distribution philosophy, attempting to establish "closer relations with a smaller number of strong independent retailers."

Durham Furniture currently buys around 50 percent of its total raw materials in the US. This has "nothing to do with trade liberalisation," however, since the materials they purchase are not available in Canada. For example, virtually all of their Cherry wood is purchased in the US for the simple reason that high quality Cherry does not grow in Canada. Conversely, all of the company's Maple is purchased in Canada because of ample local supplies.

Durham has a high degree of commitment to its Canadian location, and particularly to its employees, which is not surprising given the involvement of local investors. Over the years, several overtures have been made by potential buyers from the US, all of which have been resisted by Durham management. While the received wisdom is that costs of production are lower in the US, Durham does not believe that lower costs are achievable across the border because of hidden costs such as private health care in the US.

Palliser Furniture Ltd.

Palliser Furniture Ltd. is a firm privately held by the DeFehr family with majority control held by the company's President. It was established in 1944 in Winnipeg, Manitoba to make wooden products, making the switch to residential furniture in 1950. Today, Palliser supplies the bedroom and living room market segments. In addition to the products manufactured in-house, Palliser also operates a small trading business to import coffee tables for the US and Canadian markets from Asia (primarily Chinese Taipei) and Mexico.

Since the early 1960s, Palliser has experienced strong sales growth. Between the period 1960-1980, for example, the firm's sales increased at a compounded annual rate of about 25 percent. From 1980-1989, this rate of increase slowed to 18 percent per year. In the years 1990-1995, sales continued to grow at 8-10 percent per year with total annual sales surpassing $Cnd 200 million by 1992. Throughout this latter period, sales growth came exclusively from exports to the US, with sales in Canada virtually unchanged. However, domestic sales still account for 70 percent of total sales. Since 1996, sales growth has once again risen to 18 percent per year with total annual sales reaching $Cnd 370 million in 1997. Today, Palliser is one of the largest furniture manufacturers in Canada and the second largest private employer in Manitoba. It also has plants in Alberta, North Carolina, and Mexico.

Palliser's began exporting in the late 1960s. By 1973, total exports to the US accounted for 20 percent of the firm's total sales. However, faced with an appreciating $Cnd, exports became increasingly difficult and in 1975 the company completely withdrew from the US market. It returned in 1981 through the establishment of a small plant in Fargo, North Dakota just across the border from their main Winnipeg facility.

Palliser's initial response to the impact of trade liberalisation was the realisation that "neither the main Winnipeg facility nor the Fargo plant were strong enough to compete on a North American basis." Soon after the FTA came into effect, there was intense downward pressure on prices in Palliser's domestic market. Palliser responded by looking "more seriously and further afield to capture savings to enable to firm's finished goods to remain cost competitive."

Palliser's first priority was to "protect their Canadian sales base and then to attempt to grow through exports to the US." Their strategy, implemented over the period 1989-1991, focused on increasing the firm's competitiveness by redefining their markets, rationalising distribution channels, and shifting manufacturing locations. The net result of these initiatives was an "overall productivity increase in the range of 30 percent."

Palliser modified their product line in a number of ways in order to maximise the efficiencies of their product mix. For example, they decided to eliminate their dining room line, concentrating instead on bedroom suites and living room furniture.

Prior to FTA, Palliser maintained a wide distribution base, with several retailers often competing with each other in the same city. After FTA, however, "it became clear that Palliser's best retailers were the ones most likely to be targeted by US furniture producers." In an effort to strengthen relationships with their top retailers before they were lured away by imports, Palliser rationalised their Canadian distribution system and eliminated almost half of their 800 retailers. The immediate impact of this rationalisation was a loss of 10-12 percent of their Canadian business.

Once the decision was made that "all of their products must be competitive in the North American market," the relatively small Fargo plant was closed and all of its business was transferred back to Canada. Subsequently, "motivated by the conventional wisdom that wage rates were lower in the US" as well as the attraction of being in close proximity to the target US markets, a facility was established in North Carolina. The firm's expectations of cost savings, however, were never realised and Palliser believes that "it is still dicey today as to whether the North Carolina operation is profitable."

Looking ahead, Palliser is "increasingly vulnerable about the fact that the vast majority of [the firm's] investments are in Canada alone." Given the importance of the labour component in total production costs (between 12-30%) and the advent of NAFTA, the firm anticipates that Mexico will play an increasingly important role in its overall production strategy. Mexican labour rates are not only much lower than in Canada, but local leather is cheap and competition for raw materials is limited.

Future Challenges

The outlook for the Canadian furniture industry today is perhaps as bright as it has ever been, despite the painful adjustment it went through in the years immediately following the introduction of the FTA. Many firms took the opportunity of free trade with the US to restructure their operations, and have as a result emerged more efficient and competitive. Yet, the industry is not without challenges ahead, and this section briefly outlines some of the more important ones.

The first challenge comes from the changing external environment.

To date, tariff reductions under the North American Free Trade Agreement (NAFTA) and the Uruguay Round of the GATT negotiations (now the WTO) have had minimal impact on the Canadian industry. Even though the tariff reductions will open the way for increased competition from Mexico and other low-cost producers, the direct impact on Canadian producers is expected to be small because Canadian manufacturers generally compete at the higher end of production. However, increased competition from low-priced Mexican furniture in the US market could pressure some US manufacturers to move up the value chain where Canadian firms tend to position themselves. There will likewise be increased competition from high-end European producers. On the other hand, some of the NAFTA provisions have improved on a number of FTA procedures, especially in the area of standards and conformance, as well as in the determination and calculation of rules of origin.

The second challenge is the industry's heavy dependence on the US market. Given the cyclical nature of the furniture industry, a down-turn in the North American market is inevitable. Unless alternative markets are cultivated, Canadian producers will not have many options in the next recession. Accelerated trade liberalisation and facilitation in APEC will open up a range of new markets for Canadian manufacturers to explore even as it exposes them to increased competition from APEC member economies.

The third challenge is the continued low productivity of the Canadian furniture industry. Compared with US counterparts, the productivity of the Canadian plants is about 20 percent lower, largely due to the lack of scale economies. Canadian plants are considerably smaller than their US counterparts and less capital intensive. Capital investment per worker has lagged behind the US and very little Research and Development is carried out domestically. The degree of vertical integration in the Canadian industry is also lower than in the US.

The fourth challenge is the rising cost of materials and supplies. Although Canada is rich in forest resources, hardwood supplies are not abundant. Canadian wood is estimated to be as much as one-third more expensive than in the US, and Canada already imports more than 10 percent of furniture wood from the US. There is room for further reductions in production costs through investment in advanced technologies and innovative design techniques that improve on the usage of raw materials, as is generally the case in Europe.

Finally, a major challenge facing the industry is the difficulty it faces in securing a quality workforce. With the growing emphasis on high-quality, design-intensive furniture and customer services, the industry must recruit workers with these new skill sets. Persistent low levels of investment in human resources development and training have exacerbated the workforce problem. Since 1995, however, the University of British Columbia has launched a wood processing engineering programme which is designed to address a major skills gap in the industry.